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THE REVENUE ACT OF 1918[1]

The Revenue act of 1918 which was signed by the President February 24, 1919, is the fourth great revenue measure of a notable series enacted during the present administration. The long delay in its passage has greatly handicapped the Treasury Department in the administration of collection and has been a cause of uncertainty and annoyance to business and taxpayers of all classes. In May, 1918, the President addressed the Congress urging that body to give prompt attention to this problem even at the cost of the customary summer vacation; on June 5, the Secretary of the Treasury advised Mr. Kitchin, chairman of the Ways and Means Committee, that the bill should provide for raising eight billion dollars, one third of the estimated expenses of the government for the coming year on a war basis; on September 3, the committee presented to the House of Representatives a bill estimated to raise this amount. In presenting his report Mr. Kitchin said: "In making the decision to recommend that one third of the expenditures for the current year be raised by taxes and two thirds from the sale of bonds, your Committee has been guided by conditions existing at the present time." The bill was passed by the House September 20, and the next day was referred by the Senate to the Committee on Finance.

The House increased existing tax rates, added new taxes and evinced some appreciation of the desirability of raising a substantial part of the government's requirements by taxation. But its hasty action and the radical revision of its bill by the Senate in connection with the Revenue act of 1917 led the public to expect similar results in connection with this measure so that it discounted the House bill and looked forward to the Senate's action.

While the measure was under consideration by the Senate Committee two important events occurred which necessitated changing plans. One was the passage of an act regulating the sale and manufacture of alcoholic beverages from July 1, 1919, until after

[1] Although approved February 24, 1919, and by customary practice entitled to be called the Revenue act of 1919, Section 1405 of the law itself reads "That this Act may be cited as the Revenue Act of 1918."

the demobilization of the army. This prohibition measure reduced the estimated yield from the tax on beverages by 500 million dollars. The other event was the signing of the armistice, which brought with it a reduction in the estimated expenditures of the government from approximately 24 billion dollars to 18 billion dollars. As a result the bill as submitted to the Senate provided for raising 6 billion dollars. "Taxes which can be easily borne amid the feverish activity and patriotic fervor of war times are neither so welcome nor so easily sustained amid the uncertainties, the depreciating inventories and the falling markets which are apt to mark the approach of peace," said Mr. Simmons in his report upon presenting the bill to the Senate December 6. After the bill had been passed by the Senate and while it was in conference, the Department of State announced that the prohibition amendment to the Constitution had been ratified by the requisite number of states so that the estimated yield of the new measure was again reduced by over half a billion dollars.

The chief objection to the bill on the part of the Senate minority when it was before that branch of Congress was to the provision which fixed the rates for 1920. They argued that it was advisable to wait until conditions for that year could be ascertained, while the majority held that the taxpayers were entitled to know in advance what they were to pay. Another consideration which the advocates of this provision might well have mentioned is the administrative advantage of being able to plan for the collection of the tax. Senator La Follette presented a report in which he made a plea for increasing the amount to be raised by taxation, and for eliminating the proposed taxes on occupations, amusements (especially the cheaper kind), freight and passenger rates, and consumption taxes generally, substituting therefor a heavy tax on luxuries and war excess profits. Senator Smoot presented some additional views in which he advocated raising practically the entire revenue from a 1 per cent sale tax on consumption goods. Senator Thomas described the excess profits feature as "arbitrary, unjust, and indefensible" and objected to the inheritance tax on the ground that it was an encroachment upon the taxing power of the states.

The Senate finally passed the bill December 23. About six hundred changes had been made in the House bill, hence the Conferees had a difficult undertaking. The greatest difficulties were over the rates of the excess profits tax. The Conferees managed to reach

an agreement on February 1 and the bill was signed by the President and became law February 24.

The law as finally enacted provides for raising about 6 billion dollars, four fifths to be from income and war excess profits taxes and one fifth from taxes on luxuries and semi-luxuries. The sources of revenue are almost the same as those of the act of September 8, 1916, as amended by the act of October 3, 1917, but the income and war excess profits taxes are expected to raise a larger proportion of the total than in the previous laws. The accompanying table (Table 1) shows: (1) the actual yield of the act of 1917 for the fiscal year of 1918; (2) its estimated yield for the fiscal year of 1919 if not amended or superseded; (3) the estimated revenues provided for by the recent House bill; and (4) the amount expected to be raised by the act of 1918. The estimated yield of the bill as passed by the Senate is not included because there is little difference between it and the act which was finally passed. The most striking new features in the law are the tax on the employment of child labor and a tax on the sale of luxuries to be paid by the purchaser.

The act is composed of fourteen sections or titles as follows:

I—General Definitions.
II—Income Tax.
III—War Excess Profits Tax.
IV—Estate Tax.
V—Tax on Transportation and Other Facilities and Insurance.
VI—Tax on Beverages.
VII—Tax on Cigars, Tobacco and Manufactures thereof.
VIII—Tax on Admissions and Dues.
IX—Excise Taxes.
X—Special Taxes.
XI—Stamp Taxes.
XII—Tax on Employment of Child Labor.
XIII—General Administrative Provisions.
XIV—General Provisions.

Title I—General Definitions. This title merely contains definitions of terms which apply to the whole bill; for example, definitions of such terms as "person," life insurance company," "domestic," "foreign," and "taxpayer."

Title II—Income Tax. (*a*) *Individuals.* The law provides for a normal tax of 6 per cent upon the first $4,000 of one's income above the exemptions allowed, and 12 per cent on the remainder. On income received after the taxable year of 1918, the rates are 4 and 8 per cent respectively. One of the confusing things in the

TABLE 1.—COMPARATIVE REVENUES. YIELD OF ACT OF 1917 AND ESTIMATED YIELD OF ACT OF 1918.[1]
(In millions of dollars)

Sources of revenue	Act of 1917 fiscal year 1918	Act of 1917 estimated yield 1919	Act of 1918 House bill	Act of 1918 for a 12-months' period[4]
II—Income tax				
Individual	$930.0	$930.0	$1482.2	$1432
Corporation	528.5	528.5	894.0	775
III—Excess profits tax	1791.0	1791.0	3200.0	2500
IV—Estate tax	47.5	75.0	110.0	60
V—Transportation				
Freight	30.0	75.0	115.0	115
Express	6.5	20.0	15.0	14
Persons	24.3	60.0	75.0	75
Oil by pipe lines	1.5	3.5	4.5	5
Seats and berths	2.2	5.0	6.0	6
Telegraph and telephone	6.3	14.0	17.0	17
Insurance	6.5	12.0	13.0	14
VI—Beverages	300.0	400.0	85.0[2]	75
VII—Tobacco	155.2	212.1	346.3	249.9
VIII—Admissions	26.4	50.0	95.0	50
Club dues	2.3	4.0	8.0	3.5
IX—Excise taxes				
Automobiles	24.0	41.5	120.0	71
Jewelry, sporting goods, etc.	13.0	35.0	70.5	60
Other taxes on luxuries			265.0	143.7
Gasoline			40.0	
Yachts and pleasure boats			1.0	1
X—Special taxes				
Capital stock	25.0	25.0	80.0	80
Brokers	.3	.8	1.8	1.2
Theatres	.9	1.1	2.5	2.1
Mail order sales			5.0	
Bowling alleys, billiard and pool tables	1.1	1.1	2.5	2.5
Shooting galleries			.4	.4
Riding academies			.05	.05
Business license tax			10.00	
Manufacturers of tobacco, cigars, etc.	.5	.6	74.2[3]	2.8
XI—Stamp taxes	18.8	32.0	32.0	31
XII—Employment of child labor				
Floor taxes				50
Total	$3,941.7	$4,317.2	$7,170.9	$5,788.15

[1] Compiled from the reports of chairmen Kitchin and Simmons.

[2] Original estimate $1,137,000,000. Reduction due to prohibition and food conservation features of food stimulation bill.

[3] Includes $72,000,000 from the tax on use of automobiles and motorcycles omitted in the bill as finally passed.

[4] It should be noted that the Act of 1918 did not become effective until February 24, 1919. The estimated revenue receipts under the existing law and the Revenue act of 1918, for the fiscal year ending June 30, 1919, are $6,077,200,000; and under the Revenue act of 1918 for the fiscal year ending June 30, 1920, are $4,184,510,000.

previous law was the fact that there were two rates (2 and 4 per cent), due to the fact that the act of October, 1917, did not repeal, but was superimposed upon, the act of September, 1916. A normal tax of 2 per cent was levied under each, though exemptions were $2,000 larger in the earlier law. From an administrative standpoint it is unfortunate that Congress kept a similar complication in the new law.

The following table shows the normal tax rates imposed by all of the recent income tax laws.

TABLE 2.—RATES OF NORMAL TAX OF THE FOUR INCOME TAX LAWS (PER CENT).

Amount of net income	1920	1919	1917[1]	1916	1913
	(Act of 1918)				
0-$1,000	exempt	exempt	exempt	exempt	exempt
$1,000- 2,000	4[2]	6[2]	2[2]	"	"
2,000- 3,000	4	6	2	"	"
3,000- 4,000	4	6	4[3]	2[2]	1[2]
4,000- 5,000	4	6	4	2	1
Over 5,000	8	12	4	2	1

[1] As in effect 1917. The act of 1917 provided for a 2 per cent rate to be superimposed upon the rates of the 1916 law, though with different exemption allowances as indicated.

[2] Applicable only to income of single persons or of married persons not living with wife or husband.

[3] For heads of families and married persons the rate was only 2 per cent.

In addition to the normal tax, a surtax is imposed on incomes of over $5,000. The surtax rates of last year increased by 1 per cent for every $2,500 over $5,000, up to $20,000; thence by steps of about 4 per cent until they reached a maximum of 63 per cent on amounts in excess of $2,000,000. Under the new law, the rates increase by 1 per cent for every $2,000 increase of income from $6,000 to $100,000; thence by smaller steps until a maximum of 65 per cent is reached on amounts in excess of $1,000,000. The changes made by the Senate decreased slightly the rates upon incomes of $200,000 and less, but increased somewhat the rates upon larger incomes. Table 3 shows the surtax rates as imposed by the various acts.

The personal exemption is the same as in the act of 1917; that is, $1,000 for a single person or for a married person who is not living with wife or husband; and $2,000 for a married person living with wife or husband, or for a person who maintains a home for one or more dependents. Under the former law a person who was married on December 31 was entitled to the whole exemption. According to the most reasonable interpretation of the new law,

TABLE 3.—SURTAX RATES.

Net Incomes		Act of 1918		Act of 1917[2]		Act of 1916		Act of 1913	
From	To	Rate	Total[1] surtax	Rate	Total[1] surtax	Rate	Total[1] surtax	Rate	Total[1] surtax
		(%)		(%)		(%)		(%)	
$5,000	$6,000	1	$10	1	$10				
6,000	7,500	2	40	1	25				
7,500	8,000	2	50	2	35				
8,000	10,000	3	110	2	75				
10,000	12,000	4	190	3	135				
12,000	12,500	5	215	3	150				
12,500	14,000	5	290	4	210				
14,000	15,000	6	350	4	250				
15,000	16,000	6	410	5	300				
16,000	18,000	7	550	5	400				
18,000	20,000	8	710	5	500				
20,000	22,000	9	890	8	660	1	$20	1	$20
22,000	24,000	10	1,090	8	820	1	40	1	40
24,000	26,000	11	1,310	8	980	1	60	1	60
26,000	28,000	12	1,550	8	1,140	1	80	1	80
28,000	30,000	13	1,810	8	1,300	1	100	1	100
30,000	32,000	14	2,090	8	1,460	1	120	1	120
32,000	34,000	15	2,390	8	1,620	1	140	1	140
34,000	36,000	16	2,710	8	1,780	1	160	1	160
36,000	38,000	17	3,050	8	1,940	1	180	1	180
38,000	40,000	18	3,410	8	2,100	1	200	1	200
40,000	42,000	19	3,790	12	2,340	2	240	1	220
42,000	44,000	20	4,190	12	2,580	2	280	1	240
44,000	46,000	21	4,610	12	2,820	2	320	1	260
46,000	48,000	22	5,050	12	3,060	2	360	1	280
48,000	50,000	23	5,510	12	3,300	2	400	1	300
50,000	52,000	24	5,990	12	3,540	2	440	2	340
52,000	54,000	25	6,490	12	3,780	2	480	2	380
54,000	56,000	26	7,010	12	4,020	2	520	2	420
56,000	58,000	27	7,550	12	4,260	2	560	2	460
58,000	60,000	28	8,110	12	4,500	2	600	2	500
60,000	62,000	29	8,690	17	4,840	3	660	2	540
62,000	64,000	30	9,290	17	5,180	3	720	2	580
64,000	66,000	31	9,910	17	5,520	3	780	2	620
66,000	68,000	32	10,550	17	5,860	3	840	2	660
68,000	70,000	33	11,210	17	6,200	3	900	2	700
70,000	72,000	34	11,690	17	6,540	3	960	2	740
72,000	74,000	35	12,590	17	6,880	3	1,020	2	780
74,000	75,000	36	12,950	17	7,050	3	1,050	2	800
75,000	76,000	36	13,310	17	7,220	3	1,080	3	830
76,000	78,000	37	14,050	17	7,560	3	1,140	3	890
78,000	80,000	38	14,810	17	7,900	3	1,200	3	950
80,000	82,000	39	15,590	22	8,340	4	1,280	3	1,010
82,000	84,000	40	16,390	22	8,780	4	1,360	3	1,070
84,000	86,000	41	17,210	22	9,220	4	1,440	3	1,130
86,000	88,000	42	18,050	22	9,660	4	1,520	3	1,190
88,000	90,000	43	18,910	22	10,100	4	1,600	3	1,250
90,000	92,000	44	19,790	22	10,540	4	1,680	3	1,310
92,000	94,000	45	20,690	22	10,980	4	1,760	3	1,370
94,000	96,000	46	21,610	22	11,420	4	1,840	3	1,430
96,000	98,000	47	22,550	22	11,860	4	1,920	3	1,490
98,000	100,000	48	23,510	22	12,300	4	2,000	3	1,560
100,000	150,000	52	49,510	27	25,800	5	4,500	4	3,560
150,000	200,000	56	77,510	31	41,300	6	7,500	4	5,560
200,000	250,000	60	107,510	37	59,800	7	11,000	4	7,560
250,000	300,000	60	137,510	42	80,800	8	15,000	5	10,060
300,000	500,000	63	263,510	46	172,800	9	33,000	5	20,060
500,000	750,000	64	423,510	50	297,800	10	58,000	6	35,060
750,000	1,000,000	64	583,510	55	435,300	10	83,000	6	50,060
1,000,000	1,500,000	65	908,510	61	740,300	11	148,000	6	80,060
1,500,000	2,000,000	65	1,233,510	62	1,050,300	12	208,000	6	110,060
2,000,000	†	65		63		13		6	

[1] Total surtax due on highest amount in each bracket.
[2] As in effect 1917; that is, the acts of September, 1916, and October, 1917.

however, a person married for only part of the year is entitled to such part of the total exemption of $2,000 as that part of the year is of the whole year.[2] It will be remembered that the acts of 1913 and 1916 placed the exemptions at $3,000 and $4,000. Because of the lowered exemption and the added rates the act of 1917 allowed an extra exempton of $200 for each "child," a term construed by the Treasury Department in a very literal sense to mean a "blood child of the first degree or an adopted child." The new law grants this additional exemption for each "dependent person," thus wiping out one of the unfair distinctions of the former law.

The following items are exempt from taxation and do not have to be reported on the income tax returns: (1) proceeds of life insurance policies paid upon the death of the insured; (2) amounts received as a return of premium paid under life insurance endowment or annuity contracts; (3) the value of property acquired by gift or bequest (but the income from such property shall be included in the gross income); (4) interest upon obligations of a state, territory, or of any political subdivision thereof, or the District of Columbia, or upon bonds of the United States to the extent provided for in the acts authorizing the issue thereof; (5) income of foreign governments from investments in the United States; (6) amounts received through accident or health insurance or under workmen's compensation acts or the amount of damages received on account of injuries or sickness; (7) income derived from any public utility or the exercise of any essential governmental function and accruing to any state, territory, or subdivision thereof, or the District of Columbia; (8) the amount received during the present war by a person in the military or naval forces of the United States for active service in such forces. The first four provisions are the same as in the previous law. The sixth was allowed during part of last year by a Treasury decision.

The law is not entirely clear as to the taxing of income received by state officials. Such income was specifically exempt under the act of 1917. In drawing up the new act the House faced the issue squarely and inserted a clause "including in the case of the President of the United States, the judges of the Supreme and inferior courts of the United States, and all other officers and employees, whether elected or appointed, of the United States or of any state,

[2] The income tax forms 1040 and 1040A were gotten out in accordance with this interpretation, but an office order of March 10 provided that the marital status of December 31 should determine the exemption for the entire year.

Alaska, Hawaii or any political subdivision thereof or the District of Columbia, the compensation received as such." This was struck out by the Senate Committee but was restored by the Conferees except that the word "state" was omitted. Thus the law may be interpreted either way, for the clause "or any political subdivision thereof" might logically be held to include a state; but on the other hand omitting the word "state" would imply the intention to exempt such income. There is certainly no very good economic or social reason why this large class should be exempt, but even if specifically included the courts would probably hold that the case of *Collector* v. *Day*[3] still furnishes precedent for the rule that taxing the salary of a state official is interfering with the functions of a state.[4] There is good constitutional authority for not taxing the compensation of the President and judges of the United States during the terms of office for which they had been chosen when the law was passed.[5]

The law as finally passed provided for returns to be filed on a net income basis as heretofore. The Senate provision was for a gross income basis; that is, every one who received over $1,000 or $2,000, according to his marital status, was to file a return, regardless of whether the deductions relieved him from liability to the tax or not. Under such a provision the government instead of the individual would have been the judge of whether or not he should pay a tax. This is certainly the more desirable principle, and by this method some revenue would have been received which will be missed, but it is rather doubtful whether it would have compensated for the enormous task of getting these returns filed, particularly in view of the short time which the Bureau of Internal Revenue had to prepare for the collection.

In computing net income a taxpayer may deduct the following items in connection with business or any transaction entered into for profit: (1) expenses incurred in carrying on such business, (2) losses not compensated for by insurance or otherwise, (3) depreciation of property, and (4) bad debts. Deductible expenses which are not incurred in business are limited to such items as (1) taxes, except those assessed against local benefits tending to increase the value of the property, (2) interest, except on indebtedness incurred to purchase obligations interest on which is tax exempt,

[3] Decided December, 1870. 11 Wallace 113.

[4] The "Regulations" which have been recently issued by the Bureau of Internal Revenue hold that income received from a state should not be reported as taxable income.

[5] Article III, Sec. I.

other than United States bonds, (3) losses of property if arising from fire, storm or other casualty or theft, if not compensated for by insurance. In general there is a little more generosity in the matter of deductions than under the former law, though there are still many inconsistencies. For example, a business man who must take a street car or train to work cannot deduct car fare as a business expense, yet a man who owns an automobile may claim depreciation and upkeep if he uses it in his business. Perhaps in this case the trouble lies more with the regulations than with the law.

Several features of the new law attempt to remedy obviously unfair provisions in the former laws. One difficulty arose over the question of taxing dividends paid out of earnings accumulated in previous years. As heretofore, such earnings are exempt from the normal tax in the hands of the stockholder. In cases of this kind, there are two possibilities: (1) to tax the dividend when it was received by the stockholder, or (2) to tax it when earned by the corporation. It seems unjust to make a taxpayer pay the rates of the 1917 law, if, for example, the dividend was earned in 1916. On the other hand, it is not fair to allow the recipient of a large income to escape a tax merely by stating that the dividends he received were paid out of 1916 earnings.

The act of 1917, when followed literally, caused equally difficult problems. It was necessary to know the total profits earned for the periods between declarations of dividends in 1917; and if this amount was not sufficient to cover the dividend actually distributed the difference might be allocated to a previous year. As a matter of fact, most corporations pay their dividends out of earnings of a previous year. The House bill provided that all distributions of earnings were to be taxed according to the rates in effect during the year in which the dividend was received. The Senate Finance Committee struck out this section and inserted one which was practically like that in the 1917 law, but when the bill was before the Senate it limited the provision to stock dividends received in 1918, and the Conferees further restricted it to "stock dividends received between January 1 and November 1, 1918, or declared in this period and received after November 1 and before 30 days after the passage of the act." This means that any dividend except a stock dividend received in this period shall be taxed at the rates prescribed by law for the year in which the dividend was received.

The question of the constitutionality of taxing stock dividends has not yet been settled. The acts of 1916 and 1917 unlike the

act of 1913 specifically provided that stock dividends were taxable. Hence the decision of the Supreme Court, which stated that stock dividends are not taxable under the act of 1913,[6] may not apply to the other acts. The decision was made on the ground that a stock dividend is merely a distribution of capital. In a recent case before the United States District Court of the Southern District of New York the same ruling was made; and, since this case involved the act of 1916, the decision was given that the section of that act which provided for taxing stock dividends was unconstitutional.[7] The case has been appealed to the Supreme Court and if this decision is upheld the acts of 1916, 1917, and 1918 will all be affected.

There will undoubtedly be some difficulty over the distinction between dividends of a personal service corporation[8] and dividends of other kinds of corporations. Since profits of the former are taxable in the hands of the stockholders or members, any distribution made by such a concern in 1918 is not considered a dividend and must be included in the income upon which a normal tax is paid unless there is satisfactory evidence given that this was paid out of earnings upon which the income tax had already been paid.

Payment at the source, as in the Revenue act of 1917, is limited to tax-free-covenant bonds and to income of non-resident aliens. In the latter case it is without doubt the best policy. In the former it raises several interesting problems. The act of 1917 stated that a 2 per cent normal tax was to be withheld by the debtor corporation. If exemption from the normal tax was claimed by the taxpayer, a certificate to that effect was filed with the obligor. In most cases this was probably only a theoretical withholding. When the rates were increased in the new bill, the corporations who issued these bonds seem to have found themselves in a more difficult situation than they had ever dreamed of. The wording of the new law apparently gives them a loophole to escape part of the tax for it requires the corporation to "deduct and withhold 2 per cent." The normal tax being 6 per cent on taxable incomes under $4,000 and 12 per cent on larger incomes there still remains a 4 per cent and possibly a 10 per cent tax to be paid by the obligee for which, according to the terms of most agreements,

[6] *Towne* v. *Eisner,* decided Jan. 7, 1918. 242 Fed. Rep. 702.

[7] *McComber* v. *Eisner,* decided Jan. 23, 1919.

[8] A personal service corporation is defined as one in which capital is not a material income-producing factor and whose income is due primarily to the activities of the principal owners or stockholders who are themselves regularly engaged in the active conduct of the affairs of the corporation.

he is to be reimbursed. Bonds issued recently limit this agreement to a tax of 2 per cent. The law seems to require a violation of contract, but the attitude of the government has been that it is a matter between the corporation and the bondholder and so long as the tax is paid, it cares not who pays it.

In view of the higher rates, there have been inserted several provisions to prevent undue hardship. One of the most needed is that which allows deduction of loss incurred in "any transaction entered into for profit" instead of limiting deductible losses to those sustained in a "regular business," or to losses from fire, storm, or other casualty not compensated for by insurance. Other relief provisions are those allowing deductions of net losses. One is to take care of losses incurred between October 31, 1918, and January 1, 1920, in connection with the taxpayer's regular business or the sale of plant machinery and vessels contributing to the prosecution of the war. The other is to take care of losses sustained as a result of the reduction of the value of the inventory for the taxable year or from actual payments after the close of the taxable year in pursuance of contracts entered into during the year.

A few improvements in administrative features should be mentioned. By providing four dates for payments of the tax, and by allowing individuals to file returns according to a fiscal year, not only will taxpayers be convenienced but the collectors will be given "year 'round jobs" instead of work for only a few months of each year. This should mean better office management. At first appearance one might think this would increase the expense. The collectors and most of the deputies, however, are in the permanent employ of the service, and buildings and offices are owned or leased for long periods of time. In fact, the cost of collecting each dollar of internal revenue has decreased materially in spite of the increasing work involved.[9] Another improvement is the method of adjusting refunds. Instead of the former long red tape method, taxes paid in previous years in excess of the amount due

[9] TABLE 4.—EXPENSE OF COLLECTING INTERNAL REVENUE.

Year	*Per cent*
1912	1.57
1913	1.50
1914	1.46
1915	1.50
1916	1.22
1917	.86
1918	.32

(Report of Secretary of the Treasury, 1918, pp. 491-92.)

may be credited against any income, war profits, or excess profits taxes due.

Of the administrative features which should still be improved, the most prominent is that in the case of a taxpayer who reports partnership profits for a different fiscal year than his own. If part of the partnership profits are for 1917, the rates of 1917 are to apply to that part. The difficulty which arises in this case is to determine not only whether it is a 2 per cent or 4 per cent rate, but also how to pro-rate the personal exemption. The law provides also for allowing as a credit the taxpayer's proportionate share of dividends and interest on bonds issued by the United States which were received by the partnership. The law regulating the amount of interest from Liberty Bonds free from tax is a most complicated and ambiguous measure,[10] and, when it is made more complex by attempting to pro-rate and credit the interest, the taxpayer is apt to consider the time and trouble of making the calculations worth more than the allowable deduction.

Title II—Income Tax. (b) Corporations. The second part of the income tax law deals with corporations. Partnerships and "personal service corporations" are not taxable as corporations, but the profits are taxed as income of the individual partners or stockholders. With these exceptions, the list of corporations which are not subject to this section of the income tax reads very much the same as in former laws. It includes labor or horticultural organizations, mutual savings banks not having a capital stock represented by shares, fraternal beneficiary societies or orders, civic leagues, clubs organized for pleasure, and similar organizations. The Senate inserted a special section dealing with life insurance companies but this was struck out by the Conferees.

The rate prescribed for the taxable year 1918 is 12 per cent; that for 1919, 10 per cent. The House proposal was for a much

[10] For two years after the expiration of the war there shall be exempt:

1. Interest on bonds of the Fourth Liberty Loan, the principal of which does not exceed $30,000.

2. Interest received after January 1, 1918, on amount of bonds of the first loan converted December 15, 1917, or May 9, 1918; of the second loan, converted or unconverted, the principal of which does not exceed $45,000, providing that no such exemption shall be allowed on interest from bonds the principal of which exceeds one and one half times the amount of the Fourth loan, originally subscribed for and still held.

3. Interest on bonds issued upon conversion of those of the first to those of the fourth the principal of which does not exceed $30,000.

In addition to the above, there is a permanent exemption of interest received from bonds of all issues the principal of which does not exceed in the aggregate $5,000.—Section I of the Supplement to the Second Liberty Bond act approved September 24, 1918.

more complicated scheme, namely, "18 per cent of the amount of the net income in excess of the credits . . . provided that the rate shall be 12 per cent upon so much of this amount as does not exceed the sum of (1) the amount of dividends paid during the taxable year, plus (2) the amount paid during the taxable year out of earnings or profits in discharge of bonds and other interest bearing obligations outstanding prior to the beginning of the taxable year, plus (3) the amount paid during the taxable year in the purchase of obligations of the United States issued after September 1, 1918. . . ." The distinction between the rates on the amount distributed as dividends and other earnings was made so as to encourage distribution of profits and thus more surtax would be paid by individuals.

In computing the tax a corporation may credit: (1) the amount received as interest upon obligations of the United States, (2) the amount of excess profits tax imposed by the United States, (3) in the case of domestic corporations, income and excess profits taxes paid to any foreign country or possession of the United States, and $2,000. Among the allowable deductions is included such part of the cost of amortization of buildings or vessels used in the war, or contributing to the prosecution of war, as had been borne by the taxpayer. A special provision was made by the Senate to take care of cases in which the taxpayer had discovered oil and gas wells or mines on or after March 1, 1913, and where the fair market value upon which depreciation would ordinarily depend is materially disproportionate to cost. The allowance for depletion and depreciation is to be based on the fair market value of the property on the date of discovery or within twelve months thereafter. In the final enactment "twelve months" was changed to "thirty days." Experience under the act of 1917 proved that some such provision as this was needed.

One of the interesting new administrative features is that requiring consolidated returns by companies which are affiliated. Only one specific credit is allowed, so that in all probability this will mean more revenue to the government, though equally convincing data have been produced on both sides of the question. The law states that two or more corporations shall be deemed to be affiliated "if one corporation owns directly or controls through closely affiliated interests or by a nominee substantially all the stock of the other or others. . . ." Just what is meant by "substantially all the stock" will doubtless have to be settled by the courts.

In order to prevent corporations from accumulating their profits so that taxpayers would be relieved of paying surtax on dividends, the law states that if a corporation is formed or availed of for this purpose, the corporation is not subject to tax but the stockholders or members shall be taxable as in the case of a partnership or personal service corporation. "The fact that any corporation is a mere holding company or that the gains and profits are permitted to accumulate beyond the reasonable needs of the business shall be prima facie evidence of a purpose to escape the surtax; but the fact that gains and profits are in any case permitted to accumulate and become surplus shall not be construed as evidence of a purpose to escape the tax unless the Commissioner certifies that in his opinion such accumulation is unreasonable for the purposes of the business." Under the act of 1917, an additional tax of 10 per cent was levied upon the amount of earnings which remained undistributed, except such amounts as were employed in the business or invested in obligations of the United States.

The law provides for the same informational returns as the previous act, that is, they are required from those paying out salaries, interest, rent or other profits or income of or at the rate of $1,000 or more per year, and they may be required from (a) those collecting interest on bonds or similar obligations of corporations, (b) those collecting interest on bonds and dividends from foreign corporations, (c) stockbrokers. It is rather surprising that the stockbroker group was included, for last year the forms were not even printed.

Title III—War Excess Profits Tax. As suggested by the title given this section, the Senate combined two methods of reaching large profits and those which were earned by reason of the war. The rates are as follows (for 1918):

1st bracket—30 per cent of the amount of the net income in excess of the excess profits credit and not in excess of 20 per cent of the invested capital.

2d bracket—65 per cent of the amount of the net income in excess of 20 per cent of the invested capital.

3d bracket—The sum, if any, by which 80 per cent of the amount of the net income in excess of the war profits credit exceeds the amount of tax computed under the first and second brackets.[11]

[11] A simple example may show more clearly how these taxes would be computed.

The A company has a capital of $100,000, average pre-war net income $7,000 and a net income for the taxable year of $75,000.

The excess profits credit will be $3,000 plus 8 per cent of the invested

For the taxable year 1919, the rate of levy under the first bracket is reduced to 20 per cent, that of the second to 40 per cent, and the third is omitted. But in order to reach "war profits" a clause was inserted by the Conferees taxing the net income of every corporation which derives more than $10,000 from any government contract made between April 6, 1917, and November 11, 1918.

As passed by the House, these two methods were separated and the corporation was to use whichever was higher. The Senate amendment has accomplished the same result in a much more desirable way.

The new law has given up the excess profits tax at the flat rate of 8 per cent which was imposed last year upon amounts over $6,000 received by individuals and corporations from business having insignificant amounts of invested capital. Hence the excess profits tax now applies only to corporations having invested capital.

A small corporation is often at a disadvantage when the tax depends on the relation between its invested capital and its income because the amount of credit is based on invested capital. For this reason a relief section was inserted to apply to such cases. It states that the tax for the year 1919 shall not be more than (1) 30 per cent of the amount of net income in excess of $3,000 and not in excess of $20,000 plus (2) 80 per cent of the amount of net income above $20,000. For 1920 the rates are reduced to 20 per cent and 40 per cent of these amounts respectively.

The credits allowed in computing the excess profits tax are (a)

capital, a total of $11,000. The amount of the net income taxable at each rate of the excess profits tax will be as follows:

(1) In excess of the credit and not in excess of 20 per cent of the invested capital ($20,000-$11,000) $9,000
(2) In excess of the invested capital ($75,000-$20,000) $55,000

The rate on the amount in the first bracket is 30 per cent, the second 65 per cent, hence the tax is 30 per cent of $9,000 ($2,700) plus 65 per cent of $55,000 ($35,750), a total of $38,450.

The war profits credit will be $3,000 plus $10,000 (10 per cent of the invested capital), a total of $13,000.
Net income in excess of the credit ($75,000-$13,000) = $62,000
80 per cent of $62,000 is $49,600.
$49,600-38,450 = $11,150, war profits tax.
The normal tax of this company would be $2,808.
The total tax due is therefore as follows:

Normal tax	$2,808.00
Excess profits	38,450.00
War profits	11,150.00
TOTAL	$52,408.00

Under the 1917 law, the total tax would have been $35,336.00

$3,000 and (b) an amount equal to 8 per cent of the invested capital for the taxable year.

The "war profits credit" is (a) $3,000 and (b) an amount equal to the average net income of the corporation for the pre-war period (1911, 1912, 1913) plus or minus, as the case may be, 10 per cent of the difference between the average invested capital for the pre-war period and the invested capital for the taxable year. If the amount computed under (b) is less than 10 per cent of the invested capital for the taxable year, or if the corporation had no net income for the pre-war period, the war profits credit is the sum of $3,000 and 10 per cent of the invested capital for the taxable year.

If the corporation was not in existence during the whole of at least one calendar year during the pre-war period, the war profits credit shall be the sum of $3,000 and an amount equal to the same percentage of the invested capital for the taxable year as the average percentage of net income is to invested capital for the pre-war period of corporations engaged in a trade or business of the same general class as that conducted by the taxpayer, provided that it shall not be less than 10 per cent of the invested capital for the taxable year.

Invested capital includes: (1) actual cash paid for stock or shares; (2) actual cash value of tangible property; (3) paid in or earned surplus and undivided profits; (4) intangible property actually exchanged for stock or shares issued therefor, not exceeding (a) the actual cash value of such property at the time paid in, (b) the par value of the stock or shares issued therefor, or (c) in the aggregate 30 per cent of the par value of the total stock or shares of the corporation outstanding on March 3, 1917, whichever is lowest; (5) intangible property (*i.e.*, patents, copyrights, secret processes, goodwill, trademarks, *et cetera*) for stock or shares not exceeding (a) the actual cash value of such property at the time paid in, (b) the par value of the stock or shares issued therefor, or (c) in the aggregate 30 per cent of the par value of the total stock or shares of the corporation outstanding at the beginning of the taxable year, whichever is lowest. The term "invested capital" does not include borrowed capital.

From the invested capital must be deducted a percentage of the invested capital equal to the percentage which the amount of inadmissible assets (securities, the interest from which is tax exempt) is of the amount of admissible assets held during the tax-

able year. This deduction cannot be made in the case of a dealer in securities, an insurance company, a bank or a loan and trust company, which includes all income from inadmissible assets in computing its net income for taxable purposes. This last section was written to prevent discrimination against any business dealing largely in tax exempt securities.

In order to encourage the production of gold, the income received by a corporation engaged in gold mining is exempted from excess profits taxes. This subsidy is unwise. In fact, the general stock of money in the United States now includes over 60 per cent more gold than it did August 1, 1914. The trouble is due to the excess of credit inflation. The natural, automatic, and salutary check to such inflation, namely, the high cost of gold, has begun to operate. For the benefit of the country at large it would be just as well if this business became unprofitable so that a smaller amount of gold would be produced and prices would fall. Certainly there should not be any artificial stimulation of gold output.

The difficulties involved in determining the meaning and interpretation for tax purposes of such terms as "invested capital," and "intangible assets" are shown by the zealous and lengthy attempts to define and explain these terms. After these efforts, which cover several pages of print, there is added in apparent desperation a section which provides a new method for making the computation. In the following cases the tax shall be the amount which bears the same ratio to the net income of the taxpayer as the average tax of representative corporations engaged in a like or similar trade or business bears to their average net income for such year:

a. Where the commissioner is unable to determine the invested capital. . . .

b. In the case of a foreign corporation.

c. Where a mixed aggregate of tangible property and intangible property has been paid in for stock or for stock and bonds and the commissioner is unable satisfactorily to determine the respective values of the several classes of property at the time of payment or to distinguish the classes of property paid in for stock and for bonds.

d. Where upon application by the corporation, the commissioner finds and so declares of record that the tax if determined without benefit of this section would, owing to abnormal conditions affecting the capital or income of the corporation, work upon the corporation an exceptional hardship evidenced by gross disproportion between the tax computed without benefit of this section and the tax computed by reference to representative corporations.

Besides these "special" provisions for computing the tax, there are numerous relief clauses providing for the amortization or obsolescence of property used in the war which cannot be used in business after the war, and providing also for cases in which the net income is abnormally high due to the realization of gains or profits earned during a period of years or from the sale of property, the principal value of which is due to exploration or prospecting by the taxpayer. If the business has been reorganized the tax is to be computed according to regulations prescribed by the commissioner. With all these provisions it seems that there should be no hardship suffered by any corporation.

It would appear at first glance that an 80 per cent tax is high, but it is justly so, for nothing seems quite so unethical as to have a few individuals make a fortune out of a world calamity. In reality, however, the law will reach much less than 80 per cent of war profits because of the credits and exemptions which may be deducted. For example, there is a specific exemption of $3,000, and a deduction of a certain per cent of the invested capital from the net income, computed after the deduction of all business expenses. The minimum rate of this credit or deduction is 10 per cent, which, as has been pointed out in Senator La Follette's report, may be a much larger percentage of the net income. If the profits are 10 per cent of the invested capital, the deduction is 100 per cent of the income.

There are other considerations which must be taken into account in any discussion of war profits taxes. According to Professor Friday's estimates of the national income, the increase was from approximately 30 billion dollars in 1910 to 65 billion in 1917.[12] Of this, the income of industrial organizations increased from 19 billions to almost 49 billions, while commercial and professional incomes increased from 11 billions to 15 billions. This great increase was due partly to the fact that there was an increased output of goods. More laborers were working and they worked more continuously for there were fewer strikes. The second reason is that about 15 billions had been invested in new machinery. There is every indication that dividend payments for 1918 were slightly less than for 1917. Financial, public utility, and railroad corporations will probably show net incomes smaller than in 1917. Dividends of miscellaneous corporations and mercantile corporations are also likely to decrease slightly. If these

[12] David Friday, "Taxable Income of the United States," *Journal of Political Economy,* December, 1918.

assumptions are correct, the taxable incomes of corporations and also of individuals will be smaller in 1919 than they were in 1918. This is an added reason for increasing the war profits tax. Corporate net income for 1917 was about 10.5 billions, for 1918 not quite 10 billions; but the invested capital for 1918 was 4 billion dollars greater than in 1917. Deducting 10 per cent of the invested capital as the law provides leaves a little over 4 billion dollars subject to war profits tax. Of this the tax will reach only about 2.4 billions. Obviously, this is the last opportunity to reach war profits. The amount needed to finance the government, above that raised by taxation, will have to be raised by bonds, thus incurring further obligations for the payment of interest and raising prices by inflation, which will add to the already huge debt and interest burdens besides adding to the inflation which has resulted in such high prices.

Title IV—Estate Tax. Instead of a tax on the transfer of the estate, as the previous law and the recent House bill provided, the Senate provided for a tax on the amount inherited by each beneficiary, regardless of his or her relation to the decedent. The Conferees reinserted the House provision except that they lowered the rates. Property inherited from a person dying during the war, or within one year after its termination, from injuries received or disease contracted in such service is not subject to this tax.

The rates in the new law are somewhat lower than in the previous law for estates of $1,500,000 and less, and they are much lower for all amounts than the rates of the House bill as Table 5 shows.

This tax was looked upon as a kind of encroachment on the rights of the states by at least one member of the Senate Finance Committee. To be sure most states have inheritance taxes, but this is not a sufficient reason for its abandonment by the federal government. Such a tax provides a simple method for getting revenue, and the expenses of the government are so great at this time that every reasonable source should be utilized. Funds thus secured might well be devoted to paying the war debt or be put into capital assets instead of being used for current expenses. The rates of the present law are not so high as to discourage seriously either industry or thrift.

Title V—Tax on Transportation and Other Facilities and Insurance. The tax on the transportation of freight remains at 3 per cent as under the act of 1917; that on tickets also remains at

TABLE 5.—ESTATE TAX RATES.

Amount of net estate[1] between	Rates on net estate (per cent)		
	Act of 1917	Act of 1918 House bill	Act of 1918 as approved
0- $50,000	2	3	1
$50,000- 150,000	4	6	2
150,000- 250,000	6	9	3
250,000- 450,000	8	12	4
450,000- 750,000	10	15	6
750,000- 1,000,000	10	15	8
1,000,000- 1,500,000	12	18	10
1,500,000- 2,000,000	12	18	12
2,000,000- 3,000,000	14	21	14
3,000,000- 4,000,000	16	24	16
4,000,000- 5,000,000	18	27	18
5,000,000- 8,000,000	20	30	20
8,000,000-10,000,000	22	35	22
10,000,000	25	40	25

[1] An exemption of $50,000 is allowed in computing the value of net estate of residents of the United States.

8 per cent; but the rate on seats, berths, or staterooms in parlor cars or sleeping cars has been reduced from 10 per cent to 8 per cent. This change was made because the United States Railroad Administration plans to issue a ticket covering both transportation and Pullman accommodations.

The rate of the tax on telephone, telegram, or cable messages, for which the charge is over 14 cents but not over 50 cents remains at 5 cents, but a new tax of 10 cents has been levied in cases where the charge is over 50 cents. Another new section is that which levies a tax of 10 per cent of the amount paid to any telegraph or telephone company for a leased wire or talking circuit special service except when such service is used by the press, or "in the conduct by a common carrier or telegraph or telephone company of its business as such." With this provision the House estimated it would raise 16 million dollars of revenue from extra taxes upon telephone and telegraph business instead of 6 millions as under the act of 1917.

The rates of taxes on insurance as provided in the House bill were as follows: 8 per cent on each $100 for which a life was insured, except that on policies of $500 or less issued on the industrial or weekly or monthly plan the rate was 40 per cent of the first weekly premium or 20 per cent of the amount of the first monthly premium; for policies of insurance against fire, lightning

or casualty, 1 per cent on each dollar of the premium charged. The Senate amended this section by striking out the above and inserting a provision for levying a tax of 1 per cent of the excess of the gross amount of premiums charged for policies issued by mutual insurance companies over the amount of premiums paid for reinsurance, return premiums, and premiums refunded; in the case of other companies the rates were differentiated—for example, $1\frac{1}{2}$ per cent of such excess in the case of casualty insurance, $2\frac{1}{4}$ per cent in the case of marine and inland insurance. This change was necessitated by the fact that the Senate inserted a special section in Title II (Income Tax) providing for the taxing of insurance companies. The bill as finally passed follows the House provisions.

It is estimated that about 200 million dollars will be raised by the taxes provided for in this title, of which 75 million will be from the tax on freight, 60 million from the tax on passenger tickets, 5 million from that on seats and berths, 16 million from telegraph and telephone, and 10 million from that on insurance.

Title VI—Tax on Beverages. The tax as levied in this title by the House was expected to raise over a billion dollars, but owing to the regulations passed for limiting the production and sale of alcoholic beverages this estimate was reduced by 500 million dollars.

The Senate Committee revised the rates downward, leaving that of non-beverage alcohol at $2.20 a gallon, the same as under the 1917 law, and reducing the tax on distilled spirits drawn for beverage purposes from $8 to $6.40, double the rate previously levied, in order to secure the greatest possible amount of revenue. Inasmuch as the prohibition amendment has been ratified and goes into effect before the war prohibition measure expires, it is estimated that only $75,000,000 will be yielded by this tax.

The provisions for securing records of the amount of spirits in cisterns, tanks, or containers of any kind are left indefinite: "The Commissioner . . . is hereby empowered to prescribe all necessary regulations relating to the drawing off, transferring, gauging, storing and transporting of such spirits; the records to be kept and returns to be made; the size and kind of packages and tanks to be used, the marking, handling, numbering and stamping of such packages and tanks to be used. . . ." It is well known that this is one of the most difficult of all taxes to assess. The deputy collector goes into a warehouse and has no knowledge, other

than the word of the owner or manager, as to the contents of any of the containers. The law very properly provides for the installation of accurate meters, without which there is every chance for undue influence being brought to bear upon the officer.

One of the provisions of this title places a tax of one cent for each ten cents or fraction thereof paid for all goods bought at a soda fountain. The tax is not high enough to discourage wasteful or unnecessary consumption nor will it bring in much revenue to the government. It will prove a most annoying measure from the taxpayer's point of view and will be difficult of collection, because there is no way of finding out whether these pennies are properly put aside for Uncle Sam or get into the pockets of the dispenser of sundaes.

Title VII—Tax on Cigars, Tobacco, and Manufactures thereof. The rates of tax on manufacturers or importers of cigars, cigarettes, etc., as passed by the House were reduced very noticeably by the Senate. But even so, they are higher than last year. The rates on cigars are from $1.50 to $15 per thousand according to the weight and price at which they are to retail; on cigarettes, from $2.90 to $7.20 per thousand; on tobacco and snuff, manufactured or imported, 18 cents a pound. Under the act of 1917 the rates on cigars were from $1 to $10, on cigarettes from $2.05 to $4.80, on tobacco and snuff 13 cents per pound. The floor stock tax on cigars, cigarettes, and tobacco is the difference between the tax paid under existing law and the tax imposed by the new bill. A new section was added which repealed the so-called "free-leaf act" appearing in the act of August 5, 1909. By this provision retail dealers in leaf tobacco carried on their business with no tax liability. Another improvement is the section which provides for better records of the disposition and handling of leaf tobacco. This is one of the cases where the rates should be as high as the traffic will bear.

Title VIII—Tax on Admission and Dues. The rates of tax on admissions are left practically the same as in the previous act, though in one or two cases are increased slightly. The House proposed a 20 per cent tax on admissions over 10 cents. In case tickets are sold by "scalpers" or others at a price not to exceed 50 cents more than the established price, the House rate was 5 per cent, the Senate 10 per cent. When the price is more than 50 cents in excess of the regular price, the rate is 20 per cent; the rate proposed by the House was 30 per cent. A rather compli-

cated clause has been inserted taxing amounts for admissions to cabarets or similar places to which the charge of admission is included in the price paid for refreshments. The law states that in this case, the amount paid for admission is to be considered 20 per cent of the amount paid for refreshments and the tax is to be paid by the person paying for such service. This will probably be confusing for patrons to compute, a nuisance to the manager of the place, and will probably yield a very small amount of revenue, but it may discourage extravagance.

The tax rate on club dues remains at 10 per cent of annual dues and initiation fees amounting to over $10, although the House proposed a rate of 20 per cent. The Senate struck out the House provision which made the tax applicable to dues paid to produce exchanges, boards of trade and similar organizations.

Title IX—Excise Taxes. This section is divided into two parts, the first deals with cases in which the tax is to be paid by the manufacturer, and the second in which the tax is to be paid by the purchaser. Those of the first group are makers of such luxuries as automobiles, musical instruments, tennis rackets, canoe paddles, pleasure canoes if sold for more than $15, firearms, cameras, hunting knives, chewing gum or substitutes therefor, candy, hunting garments, articles made of fur, toilet soap, etc.

Purchasers shall pay a tax of 10 per cent of the amount paid for such articles as the following: picture frames costing over $10 each, purses over $7.50, fans over $1, women's hats over $15, shoes over $10 a pair, waists over $15, men's shirts over $3, men's silk hose over $1 a pair. The House bill provided for taxes on the purchase of women's suits and coats retailing for more than $50, on dresses retailing for over $40, and on men's suits and coats retailing for over $50 each, but the Senate did not concur. It is, of course, difficult to find the marginal price at which necessities become luxuries, but there certainly could have been found some limit above which the purchase prices of suits and coats represent ability to pay a tax.

Taxes such as those provided for in this title may serve one of two purposes: either to provide revenue or to discourage the buying of luxuries. The two results are not likely to be achieved in the same bill, because if the rates are high enough to accomplish the latter, not as much revenue will be produced as if the rates were lower. The higher rates as provided by the House might well have been retained, for the days are not yet passed when we as a coun-

try can afford to abandon the practice of thrift which became popular as well as patriotic during the war.

Some criticism has been made against this method of raising revenue because it will entail entirely new machinery for collection. The difficulties in this respect seem to be more than overcome by the advantages which are secured.[13]

Title X—Special Taxes. This title contains provisions for laying an excise tax on manufacturers of cigars, persons carrying on businesses such as those of corporations, brokers, and proprietors of theaters, museums, bowling alleys, riding academies, breweries, circuses, and passenger automobiles for hire. To the extent that the tax reaches those who would not pay a tax under any of the other provisions, this may prove a desirable "catch all," though it is open to some objections. For example, the law taxes a corporation $1 for each $1,000 over $5,000 of the amount of its assets at the close of its fiscal year, thus taxing a third time those taxable under Titles II and III. Manufacturers of tobacco pay taxes under this Title and also under Title VII. It would save much confusion and unnecessary difficulty in collection if the rates under one title were sufficient to cover all taxes in any particular case. The House proposed a kind of federal license for motorcycles and automobiles which was omitted by the Senate.

The last part of the title provides for a tax on importers, manufacturers, or sellers of opium and other habit-forming drugs. The rates are as follows: importers, manufacturers, producers, or compounders, $24 a year; wholesale dealers $120 a year; retailers $6; doctors, dentists, and others $3; and a further tax of one cent per ounce shall be paid upon such drugs produced, sold, or removed for consumption or sale. This is to take the place of the act of December, 1914, which provided for a tax of $1 to be paid by a manufacturer or vendor of opium, but exempted doctors, dentists, and those who used these drugs in their professions. It has been held by the courts[14] that, under this act, a person having in his possession any habit-forming drugs is not criminally liable unless he is a dealer. This has made enforcement of the act very difficult. The law of 1918 provides that the possession of an unstamped package shall be prima facie evidence of violation of the act.

[13] The House passed a resolution March 1, 1919, providing for the repeal of the luxury tax and the Senate was expected to concur, but this measure, along with many others, was killed by the filibuster which occupied the closing hours of the session.

[14] The Supreme Court in the Jim Fuey Moy case, June 5, 1916. 241 U.S. 394.

This is certainly one of the taxes which ought to be heavy enough to drive out the business except for medicinal purposes, if there is no better way of accomplishing this end. Any such tax requires a large force of alert and dependable officers to prevent smuggling and evasion of every kind.

Title XI—Stamp Taxes. These taxes are practically the same as last year, that is, they apply to certificates of indebtedness, bonds, certificates of capital stock, the sale of produce on an exchange, deeds, proxies for voting at any election of officers, except religious or charitable societies, power of attorney, and parcel post packages where the postage amounts to 25 cents or more. Such taxes as these are simple from the administrative point of view and yield some revenue. For the fiscal year 1918, 8 million dollars was raised from such a tax, and it is estimated that 31 million dollars will be raised this year.

Title XII—Tax on Employment of Child Labor. This is a clear case of a tax being levied for other than revenue purposes. It was passed to take the place of the child labor law which the Supreme Court declared unconstitutional last June in a five to four decision.[15] There was some discussion in the committee as to whether or not this section of the law is constitutional. It is common practice to insert in revenue bills "riders" of this character.

The law provides for levying a tax of 10 per cent of the net profits of any mine, quarry, mill, cannery, workshop, factory, or manufacturing establishment in which are employed children under sixteen in the case of mines or under fourteen in the cases of any of the other establishments named.

In computing net income, there may be deducted from gross income the cost of raw materials, running expenses, interest on business obligations, taxes, and losses. Provision is made to prevent any person from selling the products of his establishment at less than fair market price by considering for tax purposes that the gross amount received for the year or from the sale is the amount which would have been received if the goods had been sold at the fair market price.

There will be the same difficulty found in administering this law as in other laws in which the age of children must be ascertained. A country should provide for birth registration before attempting legislation of this kind. Especially difficult will be the cases which will arise in the mountain country of the South where par-

[15] *Hammer* v. *Dagenhart,* U.S. 62 L. ed.

ents are ignorant, illiterate, and careless. It is, however, better than no law at all.

Title XIII—General Administrative Provisions. This title is a miscellany of some twenty sections dealing with various phases of administering the law. One of the significant features is the establishment of two boards, a Legislative Drafting Service and an Advisory Tax Board. The former is to be under the direction of two draftsmen, one to be appointed by the President of the Senate, the other by the Speaker of the House of Representatives without reference to political affiliations. Its function is to aid in drafting public bills and resolutions.

The Advisory Tax Board is to be appointed by the Commissioner of Internal Revenue. The number of members is not specified in the law as it was passed, though the House provided for five. From the statement in the law, it looks as though this board would be the present Board of Reviewers under a new name, for their function is to adjust problems which arise in connection with the interpretation and administration of the income tax and war excess profits tax laws.

Title XIV—General Provisions. This is another section containing miscellaneous provisions and several "riders." For example, there is one for the payment of $60 to persons serving in the military or naval forces of the United States who have been discharged since November 11, 1918; another reducing on July 1, 1919, the postage rates on first-class mail matter to those in force October 2, 1917; and another for making the District of Columbia "bone dry." The Conferees struck out a clause which the Senate had inserted for abolishing the zone system of postage rates on second-class mail matter.

Another provision of importance properly belonging with these sections, though included in Title II, was one inserted by the Senate which imposed a tax of 100 per cent on all contributions over $500 made by a person or corporation to any national political campaign, not including expenditures made by candidates out of campaign funds lawfully contributed. Unfortunately it fell by the way in conference.

This amendment required every person who makes an income tax return to state each gift made for influencing an election at which are to be nominated or elected presidential electors or members of the House of Representatives or of the United States Senate. The treasurers or chairmen of all state and congressional

committees were to file returns within 30 days after the passage of the act and within 30 days after an election showing the amount of all gifts, from whom received, and the date received. The administrative machinery for "checking up" had been provided by the act of June, 1910, relative to the publicity of contributions for influencing elections at which members to Congress are elected. This tax should have lessened corruption and other undue influence in elections.

Summary

The most significant feature of the new revenue act is the place it gives the tax on income, including the tax on excess profits, which is merely an extension of the income tax. As mentioned in the introduction, this is the fourth in a series of great revenue measures enacted during the present administration. These four acts have provided for rapidly increasing yields and they exhibit a noteworthy evolution of income tax development, in fact, a striking revolution in federal taxation. Before the war our annual federal revenues and expenditures were less than a billion dollars.[16] Prior to the passage of the Revenue act of 1913, the first of the present administration, about half of the revenues came from taxes on imports, nearly a third from taxes on liquor, and most of the remainder from taxes on tobacco.

The act of 1913 introduced a small tax on incomes and reduced the high tariff which had been maintained by the Republican party with few exceptions ever since Civil War days. Each of the three important succeeding measures has left the tariff practically untouched, but has greatly increased the scope and yield of the income tax. The decline in imports of manufactured goods during the war has tended further to reduce the yield of the tariff; and, as soon as the recent prohibition measures become effective, what used to be the second largest source of federal revenue will be eliminated. The new law provides for a total yield seven times as great as pre-war revenues to be raised from sources other than those on imports and liquor, which together formerly furnished two thirds of the total. The income and excess profits taxes are expected to yield six times the total pre-war revenues and fifteen or sixteen times the anticipated receipts from the tariff and liquor taxes.

[16] If postal revenues and expenditures, which are about equal, are included, the pre-war total was just about a billion dollars.

TABLE 6.—CHIEF SOURCES OF FEDERAL REVENUES.[1]
(In millions of dollars)

Fiscal years	1913		1914		1915		1916		1917		1918	
Source of revenue	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
Liquors	$230.2	31.7	$226.2	30.8	$223.9	32.1	$247.4	32.1	$279.4	24.2	$443.7	10.4
Tobacco	76.8	10.7	80.0	10.9	80.0	11.5	88.1	10.2	102.23	9.2	156.2	3.7
Income tax												
Individual			28.2	3.9	41.1	5.9	67.9	8.8	180.1	16.2	2838.9[4]	68.1
Corporation	35.0	4.9	32.5	4.3	39.2	5.6	56.9	7.5	179.5	16.1		
Miscellaneous[2] Internal revenue...	2.3	.3	13.2	1.9	31.4	4.5	52.3	7.0	69.1	6.5	255.8	6.3
Internal revenue..	344.4	47.6	380.1	51.8	415.6	59.6	512.7	65.6	809.4	72.2	3694.6	88.5
Tariff	318.9	44.4	292.3	39.7	209.8	30.1	213.2	27.4	226.0	20.3	182.8	4.4
Miscellaneous[3]	60.8	8.0	62.3	8.5	72.4	10.3	53.7	7.0	83.3	7.5	296.6	7.1
Total	724.1	100.0	734.7	100.0	697.9	100.0	779.6	100.0	1118.7	100.0	4174.0	100.0

[1] Compiled from the Reports of the Treasury and Reports of the Commissioner of Internal Revenue 1913 to 1918 inclusive (fiscal years).

[2] Includes taxes on oleomargarine, opium, stamp taxes, etc.

[3] Includes proceeds from sales of public lands.

[4] Includes excess profits taxes of $1,791,000,000. The detailed statistics showing distinction between taxes paid by individuals and by corporations have not yet been published.

The temporary "dry" measure goes into effect July 1, and will continue until after the army is demobilized. This means that it will overlap the date upon which the seventeenth amendment goes into effect, so that henceforth revenues from liquor will be scarcely worth considering. Taxes on tobacco will produce only one thirtieth of the total amount estimated to be raised by the new law. In all of this there has been a movement away from consumption taxes.

Another tendency has been to get more and more away from payment of the tax at the source and toward payment by the recipient of the income. The Revenue act of 1913 provided that those who paid rent, salaries, interest, and other sums should deduct the tax before paying amounts due. This provision did not work satisfactorily. It was unduly expensive and annoying and was repealed upon the recommendation of the Secretary of the Treasury, although England seems to feel that the success of her income tax has been due to its collection at the source. The Revenue acts of 1916 and 1917 substituted information-at-the-source in most cases, and, in the case of two taxes, the act of 1919 goes even farther. These are the taxes on (1) partnership profits and on (2) distributions of personal service corporations. These organizations do not pay any tax, but their profits are taxed to the recipients, as has been stated above. If some method could be devised for reaching the undistributed profits of every corporation, and if their dividends could be taxed as provided for in the case of a personal service corporation, it would eliminate much of the confusion and complexity which now surround the law and which must of necessity continue so long as corporations and individuals are taxed by different methods.

One of the characteristic features of this law as also of its predecessors is the provision for "commissioner made law." In the income tax section alone there are nineteen cases in which regulations are to be made by the Commissioner of Internal Revenue for dealing with special cases. For example, "the net income shall be computed . . . in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made upon such basis and in such manner as in the opinion of the Commissioner does clearly reflect the income." The greatest power given to him is in the section dealing with war excess profits,

where he may levy the taxes of a corporation by "the amount which bears the same ratio to the net income of the taxpayer (in excess of the specific exemption of $3,000) for the taxable year, as the average tax of representative corporations engaged in a like or similar trade or business bears to their average net income . . . for such year." This is to be done only in cases where it is impossible to determine the invested capital or where a taxpayer would be placed in a position of inequality because of the time or manner of organization. The difficulties attending all such cases are enormous and there are bound to be many such problems so long as taxes are based on anything so inherently complicated as invested capital.

Several improvements have been made in the new law, among them the provisions for the allowance of net losses, depletion, and shrinkage of inventories. The new luxury taxes, as well as the old ones, are entirely justifiable at this time. Riders in general are to be condemned, but most social reformers will make no great complaint against the tax on child labor and the provision to make the District of Columbia "bone dry." They would not have objected either if the Conferees had retained Senator Thomas' amendment to put a 100 per cent tax upon political campaign contributions in excess of $500.

On the whole, the law is an improvement over those of previous years, but it leaves too much to be raised by borrowing. Six billions is a huge sum to raise by taxes and will cause many heavy burdens, but excessive borrowing causes still heavier burdens. We agree with Mr. Kitchin and others that it was a mistake to provide for less than 8 billions by taxation even though the war is over. Our military preparations did not attain their maximum until the signing of the armistice and payments of the bills have reached their peak since that time. They have averaged 2 billions per month since the armistice was signed[17] and will probably exceed by a billion or two Secretary McAdoo's estimate of 18 billions for the fiscal year. Furthermore, expenditures for 1920 are likely to be heavy. So called "ordinary" expenditures will be reduced slowly and will never get back to their pre-war level; there will probably be many war contracts not entirely liquidated by June 30 of this year; a billion dollars will be required annually for interest on the war debt; the Secretary of the Treasury has recommended establishing a sinking fund for the gradual paying off

[17] This was written in February. Later months have averaged over a billion dollars each.

of the principal of the debt; he has also recommended further loans to former European allies so that they may not curtail too seriously our exports to them during the reconstruction period. Expenditures should be reduced as rapidly as they may be consistently with our obligations, but it does not seem probable that the requirements of 1920 can be met without the issue of bonds or certificates of indebtedness, or other forms of government securities. It is difficult to present convincing arguments why the necessity for future bond issues should not have been reduced by larger levies upon war profits. They are certainly the most legitimate source of war revenues. Many corporations had set aside adequate tax reserves out of such earnings in anticipation of the higher levies. And, besides, they can be collected now before they have been passed on to "innocent" parties more easily and equitably than at any future time.

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